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IN THE

Supreme Court of the United States

OCTOBER TERM, 1989

MARYLAND HIGHER EDUCATION LOAN CORPORATION,
Petitioner,

v.

LAURO F. CAVAZOS, SECRETARY OF THE UNITED STATES DEPARTMENT OF EDUCATION, *et al.*,
Respondents.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Fourth Circuit

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PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED

Do the 1987 amendments to the Higher Education Act of 1965, which authorize the Secretary of Education to expropriate $250 million in "excess cash reserves" held by state and private student loan guaranty agencies, violate the Fifth Amendment's Takings Clause?

LIST OF PARTIES

The parties are the Maryland Higher Education Loan Corporation (appellee below and petitioner here), the United States Department of Education, and its Secretary, Lauro F. Cavazos (appellants below and respondents here). The South Carolina State Education Assistance Authority, the State of North Carolina and the North Carolina State Education Assistance Authority were also parties to the consolidated proceeding below, and the Virginia State Education Assistance Authority and the National Council of Higher Education Loan Programs, Inc. participated in the proceeding below as *amici curiae*.

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On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Fourth Circuit

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PETITION FOR WRIT OF CERTIORARI

Over Maryland's constitutional objections, the United States Court of Appeals for the Fourth Circuit upheld the Secretary of Education's "taking" of $10.8 million. Petitioner respectfully seeks review of that judgment.

OPINIONS BELOW

The March 7, 1990 opinion of the Court of Appeals for the Fourth Circuit is reported at 897 F.2d 1272 and is reprinted in the appendix to this petition ("App.") at App. 1a-11a. The June 12, 1989 opinion

of the United States District Court for the District of Maryland is unreported and is reprinted at App. 15a-19a. The district court's decision incorporated by reference and attached the May 31, 1989 opinion of the United States District Court for the District of South Carolina in *South Carolina State Education Assistance Authority v. Cavazos*, which is reported at 716 F. Supp. 886 and is reprinted at App. 20a-37a.

JURISDICTION

The judgment of the Court of Appeals for the Fourth Circuit was entered on March 7, 1990, and on March 28, 1990, that court denied petitioner's request for rehearing and suggestion for rehearing in banc. (App. at 12a-14a.) This Court has jurisdiction pursuant to 28 U.S.C. § 1254(1) and § 2101(c).

CONSTITUTIONAL, STATUTORY AND REGULATORY PROVISIONS INVOLVED

The constitutional, statutory and regulatory provisions involved in this case are the Fifth Amendment to the United States Constitution; section 3001 of the Omnibus Budget Reconciliation Act of 1987, Pub. L. No. 100-203, 101 Stat. 1330-36, formerly codified at 20 U.S.C. § 1072(e); 20 U.S.C. § 1078(c)(1)(A) (Supp. 1986); and 34 C.F.R. § 682.410(a), all of which are reproduced beginning at App. 38a.

STATEMENT OF THE CASE

In 1987, as part of its effort to comply with the budget-cutting requirements of the Gramm-Rudman-Hollings Act, Congress amended the Higher Education Act of 1965 to abrogate pre-existing contract rights with the states and mandate the transfer to the federal treasury of $250 million from state and

private student loan guaranty agencies across the country. This confiscatory action, which cost the State of Maryland approximately $10.8 million, is challenged in this case.

A. The History And Operation Of The Guaranteed Student Loan Program.

Petitioner Maryland Higher Education Loan Corporation ("Petitioner" or "Maryland") was created in 1963 by Maryland statute as a nonprofit state corporation to provide student loans, guarantees, and other services to assist Maryland residents in financing post-secondary education. *See* 1963 Laws of Maryland; ch. 589; Md. Educ. Code Ann. §§ 18-1002, 1003 (1989). Over the years, approximately $11.5 million in state funds have been appropriated to petitioner for this purpose.

The Higher Education Act of 1965, as amended (codified in part at 20 U.S.C. §§ 1071 to 1087-2) (the "Act") established a nationwide guaranteed student loan program to finance the costs of higher education. The Act has been implemented primarily through various contracts between state and private guaranty agencies and the United States Department of Education and its Secretary (the "Secretary"). To be an eligible contracting party, a guaranty agency must operate its own guaranteed student loan program which meets federal requirements. *See* 20 U.S.C. § 1078(b)(1).

The Secretary's approval of a guaranty agency's program is embodied in a "participation agreement" between the agency and the Secretary, thereby making student loans eligible for interest subsidies paid directly to lenders. Additionally, the Secretary's ap-

proval means that a participating guaranty agency is eligible for administrative cost allowances (which partially reimburse the agency for its administrative expenses) and for reinsurance payments (which reimburse it for monies paid by the agency to lenders for defaulted loans). *See generally* 34 C.F.R. § 682.400.

The Act authorizes the Secretary to enter into reinsurance contracts with guaranty agencies, such as petitioner, and for a fee to reimburse each agency for all or a portion of claims that the agency pays to lenders of defaulted loans guaranteed by the agency. 20 U.S.C. § 1078(c). Under this program, lenders advance funds to students; Maryland is the guarantor of 100% of the loan; and the Secretary reinsures all or part of the loan for the benefit of Maryland, depending on its default rate. *Id.* In the event of default, a lender's sole right of recovery is against Maryland, not the Secretary.

Since 1968, when reinsurance was first authorized, the Act has obligated the Secretary to make reinsurance payments to guaranty agencies. Prior to the enactment of the legislation giving rise to this litigation, the Act provided as follows:

> *The guaranty agency shall be deemed to have a contractual right against the United States, during the life of such loan, to receive reimbursement according to the provisions of this subsection.* Upon receipt of an accurate and complete request by a guaranty agency for reimbursement with respect to such losses, the Secretary shall pay promptly and without administrative delay. Except as provided in subparagraph (B) of this paragraph and in

> paragraph (7) [relating to default rates and reimbursement rates for new agencies], the amount to be paid a guaranty agency shall be equal to 100 percent of the amount expended by it in discharge of its loan insurance obligation incurred under its insurance program. . . .

20 U.S.C. § 1078(c)(1)(A) (1986 Supp.) (emphasis added) (amended 1987).

Maryland entered into agreements with the Secretary which obligated him to pay up to 100% of the amounts expended by Maryland to discharge its guaranty obligations. (App. at 5a; 17a-18a.) In exchange for the Secretary's obligation to reimburse the State, Maryland actively implemented and administered the Guaranteed Student Loan Program and, more recently, has paid a reinsurance fee to the Secretary based on the principal amount of its new reinsured loans. *See* 20 U.S.C. § 1078(c)(9). As of December 22, 1987, Maryland had guaranteed to lenders, and the Secretary had reinsured, $1.02 billion in student loans.

B. The 1987 Amendments To The Act.

Effective December 22, 1987, § 3001 of the Omnibus Budget Reconciliation Act of 1987, Pub. L. No. 100-203, 101 Stat. 1330-36 ("1987 Amendments") (App. at 40a-44a) required the Secretary to determine the maximum allowable cash reserves for each guaranty agency, and authorized the Secretary to direct any agency with "excess cash reserves" to transfer such reserves to the Secretary. 20 U.S.C. § 1072(e). The new law also changed § 1078(c)(1)(A), which had provided that guaranty agencies "shall be deemed to have a contractual right against the United States,

during the life of [any insured] loan, to receive reimbursement", to provide instead that guaranty agencies "shall, *subject to section 1072(e)* [the "excess cash reserves" transfer provision] of this title, be deemed to have a contractual right against the United States. . . . " (Emphasis added.)

Thus, while the Act had previously granted guaranty agencies enforceable contractual reimbursement rights, the 1987 Amendments effectively extinguished those rights by making reimbursement contingent on the agency's having paid its "excess cash reserves" to the Secretary. This legislation was designed to help Congress meet the Gramm-Rudman-Hollings budget guidelines by directing the Secretary of Education to appropriate "$250 million from guaranty agencies to help finance federal expenditures under the GSL Program." *Delaware v. Cavazos*, 723 F. Supp. 234, 237 (D. Del. 1989) (footnote omitted).

In February, 1988, the Secretary notified Maryland that it was required to pay $10.8 million in "excess cash reserves" to the Secretary. (App. at 7a.) Maryland refused to comply with this directive, and the Secretary has since withheld the entire "excess cash reserve" amount ($10.8 million) by refusing to pay Maryland's otherwise unquestionably eligible reimbursement claims. (App. at 7a; 17a-19a.)

C. Proceedings Below.

Promptly after the Secretary first withheld reimbursement payments pursuant to the 1987 Amendments, Maryland filed this suit. The United States District Court for the District of Maryland (Hon. Frederic N. Smalkin, Judge) declared that because Maryland has an indefeasible reimbursement right

against the Secretary, 20 U.S.C. § 1072(e) violates the Fifth Amendment. (App. at 18a-19a.) The court squarely held that Maryland's reserve funds "are the property of the plaintiff, and * * * the federal government cannot simply take the cash reserves away from the plaintiff, especially through the vehicle of reneging on its obligation to reimburse for losses experienced by plaintiff in connection with previously guaranteed loans." (App. at 19a.)

The Secretary appealed, and this action was consolidated with two similar challenges to the constitutionality of the 1987 Amendments brought by the States of South and North Carolina. In *South Carolina State Education Assistance Authority v. Cavazos*, 716 F. Supp. 886 (D.S.C. 1989), the court struck down the constitutionality of § 1072(e), and in *North Carolina v. United States*, 725 F. Supp. 874 (E.D.N.C. 1989), the court upheld the constitutionality of § 1072(e). On March 7, 1990, the Fourth Circuit Court of Appeals upheld the constitutionality of § 1072(e), thus reversing the Maryland and South Carolina decisions and affirming the North Carolina decision. (App. at 11a.)

REASONS FOR GRANTING REVIEW

SUMMARY

This case presents the important question of whether Congress can reduce the federal deficit by taking property held by the states merely because a program is regulated by federal law. Maryland's position here and that of states in similar litigation pending throughout the country is that the Fifth Amendment does not permit Congress to pursue the admittedly worthy objective of reducing the enormous

federal deficit by confiscating private property. The decision below should be reviewed because it constitutes an unprecedented expansion of Congress' power to add to the federal treasury at the expense of the rights of the states to hold property and plan their affairs in justified reliance on express statutory and contractual obligations.

The Fourth Circuit's finding that § 1072(e) is constitutional conflicts with two lines of decisions in this Court. First, this Court has held that even extensive regulation of private property does not alter ownership rights in that property; and second, this Court has held that Congress' power to amend legislation does not authorize it to abrogate legally enforceable rights.

The legislation at issue in this case is being challenged by twenty-six guaranty agencies in federal courts throughout the nation, and has been declared unconstitutional by three district courts. Given the attractiveness of attempting to reduce the federal deficit by appropriating other people's money, rather than undertaking the constitutional but politically more painful tasks of cutting expenditures or raising taxes, *and* the legal uncertainty of the approach employed by Congress here, this Court should review the constitutionality of § 1072(e). Further, because the federal and state governments are involved jointly in a multitude of contractual, grant, and insurance programs, both Congress and the states need to know whether the constitutional guarantee that property cannot be taken without just compensation invalidates the deficit-reduction action challenged here.

THIS CASE PRESENTS THE IMPORTANT CONSTITUTIONAL QUESTION OF WHETHER STATE AND PRIVATE STUDENT LOAN GUARANTY AGENCIES HAVE FIFTH AMENDMENT-PROTECTED PROPERTY INTERESTS IN THEIR CONTRACT RIGHTS AND STUDENT LOAN RESERVE FUNDS.

The Fifth Amendment's Takings Clause prohibits the federal government from appropriating property that belongs to another. *See, e.g., Lynch v. United States*, 292 U.S. 571, 579 (1934). Therefore, the core issue in this case is whether Maryland's reserve funds are "private property" within the meaning of the Takings Clause.

The Fourth Circuit stated that "[t]he nature of the loan program militates against a finding that the state agencies [Maryland, North Carolina, and South Carolina] possessed [any] indicia of private ownership" in the reserve funds they hold. (App. at 9a.) It reasoned that because Maryland's reserves are extensively controlled by federal regulations, Maryland's " 'property comes within the control of the United States to such an extent that its use is ultimately under the direction of the United States, [and] it loses its character as "private" property and becomes public to such an extent that it is not subject to a takings prohibition under the Fifth Amendment.' " (App. at 9a) (quoting *North Carolina v. United States*, 725 F. Supp. 874, 876-77 (E.D.N.C. 1989)).

This analysis is severely flawed and defines "private property" in an unprecedented and unconstitutional fashion. First, as this Court has held, even extensive regulation of property does not change its essential private character, nor does it extinguish the rights of ownership. *See, e.g., Penn Central Trans-*

portation Co. v. New York City, 438 U.S. 104 (1978). Similarly, federal regulation does not convert private property into the property of the federal government. *See Forsham v. Harris*, 445 U.S. 169, 180-81 (1980); *United States v. Orleans*, 425 U.S. 807, 816 (1976); *see also Commissioner of Internal Revenue v. Lincoln Savings and Loan Association*, 403 U.S. 345, 355 (1971) (entities required by federal law to maintain reserve funds subject to extensive federal control nevertheless have "a distinct and recognized property interest" in those reserves).[1] And finally, contrary to the Fourth Circuit's suggestion (App. at 9a), the Fifth Amendment protects property used for public purposes by state and local governments no less than it protects other private property. *See United States v. 50 Acres of Land*, 469 U.S. 24, 31 (1984); *United States v. 564.54 Acres of Land*, 441 U.S. 506, 507 (1979).

In this case, there is no dispute that Maryland's reserves have always been in Maryland's possession and were derived entirely from non-federal sources.[2]

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[1] Additionally, the regulation at issue, 34 C.F.R. § 682.410(a), did not even come into existence until 1986, over 23 years after petitioner was created and had been accumulating and using its reserves to administer its student loan program. To hold, as the court below did, that the regulation "prevent[s] any of the guaranty agencies from acquiring an ownership interest in its reserve fund" (App. at 10a), is to concede that prior to 1986 such an ownership interest existed, which thus must have been taken by the 1986 regulation.

[2] Petitioner's cash reserves and operating funds have been deposited at all times in the State Treasury of Maryland. Indeed, because respondents have never had any legal or physical control over petitioner's reserves, they could only collect petitioner's "excess cash reserves" by withholding reimbursement payments

Thus, Maryland has exclusive rights to possession, use, and disposition of its reserve funds. These are the principal indicia of private property. *See Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419, 435 (1982); *Ruckelshaus v. Monsanto Co.*, 467 U.S. 986, 1011 (1984). Indeed, *before* the 1987 Amendments were enacted, Congress confirmed the private nature of the guaranty agencies and their reserves when it provided that the guaranty agencies "shall be deemed to have a contractual right against the United States, during the life of [any insured] loan, to receive reimbursement" if the loan defaults and is paid off by the agency, *see* 20 U.S.C. § 1078(c)(1)(A) (1986 Supp.), and provided further that these agencies have the right to sue the Secretary if the Secretary fails to comply with his reimbursement obligations. *See* 20 U.S.C. § 1082(a)(2).[3]

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due and payable to petitioner. Moreover, Maryland proved below that its reserves came exclusively from non-federal sources such as insurance premiums paid by financial institutions whose loans were guaranteed by Maryland, state appropriations, investment earnings, and a percentage of collected defaulted loans that were previously paid off by Maryland. Maryland received payments from the Secretary, but these funds only partially reimbursed Maryland for expenditures it made in the administration of its student loan program including payments made on defaulted student loans.

[3] *See also* H. R. Rep. No. 383, 99th Cong., 2nd Sess. *reprinted in* 1986 U.S. Code Cong. & Ad. News 2572, 2610 ("agencies have a contractual right for such [reimbursement] payments and may sue to enforce such right"). Congress clarified this contractual right in 1986 in recognition of its importance to the states' reserves and ability to successfully administer their student loan programs because "severe economic implications" and "deleterious effects on agency cash flows" would result from even a mere delay in making reimbursement payments. *Id.*

"Rights against the United States arising out of a contract with it are protected by the Fifth Amendment." *Lynch*, 292 U.S. at 579. Petitioner has a constitutionally-protected "right to receive federal * * * funds by virtue of certain congressional enactments", *Oklahoma v. United States Civil Service Commission*, 330 U.S. 127, 135-36 (1947), because it complied with all statutory conditions that existed before the 1987 Amendments were enacted when it guaranteed over $1 billion in student loans. "[I]f Congress intends to impose a condition on the grant of federal moneys, it must do so unambiguously", *Pennhurst State School & Hospital v. Halderman*, 452 U.S. 1, 17 (1981), and no excess cash reserve transfer condition existed when Maryland guaranteed those loans.

Thus, notwithstanding the need to reduce the federal deficit, the Fourth Circuit was wrong when it held that the power to amend the student loan program overcomes the command of the Takings Clause. (App. at 11a.) The power to alter, amend or repeal legislation "cannot be used to take away property already acquired * * * or to deprive [a person] of the fruits already reduced to possession of contracts lawfully made. . . . " *Sinking Fund Cases*, 99 U.S. 700, 25 L.Ed. 496, 501 (1879). Congress is simply "without power to reduce expenditures by abrogating contractual obligations of the United States. To abrogate contracts, in the attempt to lessen government expenditure, would be not the practice of economy, but an [unconstitutional] act of repudiation." *Lynch*, 292 U.S. at 580.

The massive "repudiation" at issue in this case involves the expropriation of $10.8 million of Maryland's reserves and the taking of $250 million from

guaranty agencies across the country. These agencies have guaranteed approximately $100 billion in 10 and 15-year student loans and are committed over an even longer period to spend enormous sums to service their huge loan portfolios. The reserves taken by the Secretary are crucial to the financial health and survival of state loan guarantee agencies, particularly if federal financial support declines, as it may well as part of the effort to reduce the federal deficit.[4]

The importance of these reserves is highlighted by the fact that at last count, in addition to the three states who were parties to the proceeding below, twenty-three other agencies have had their "excess cash reserves" appropriated by respondents *and* have challenged the constitutionality of the 1987 Amendments.[5] Further, two district courts in the proceed-

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[4] Maryland, for example, has incurred approximately $45 million in administrative costs with respect to its loan portfolio, which grew dramatically in the 1980's. These costs arose as a result of Maryland's enforcement of due diligence requirements, counseling financial institutions, monitoring the enrollment and repayment status of existing loans, providing pre- and post-default assistance to financial institutions, and collecting loans assigned by those institutions to Maryland after the loans have defaulted. The Secretary has only provided Maryland with approximately $10 million to partially offset these costs; the remaining costs have been offset by state appropriations and earnings derived from invested reserve funds. The Secretary's appropriation of $11 million of Maryland's reserves significantly hinders Maryland's long range efforts to administer its burgeoning loan portfolio.

[5] *See Student Loan Guarantee Foundation of Arkansas, Inc. v. Cavazos*, No. LR-C-88-862 (E.D. Ark. filed Dec. 15, 1988); *Colorado v. Cavazos*, No. 88-C-2073 (D. Colo. filed December 22, 1988) (consolidated with suits filed by Montana, New Mexico,

ings below (Maryland and South Carolina) and the District Court for the Southern District of Ohio have held that § 1072(e) is unconstitutional. *See Ohio Student Loan Commission v. Cavazos*, 709 F. Supp. 1411 (1989), *reversed*, 900 F.2d 898 (6th Cir. 1990). Review is warranted here, therefore, because the question presented by this petition is one over which the lower federal courts have differed and will likely differ in the future.

North Dakota, and Utah); *Connecticut Student Loan Foundation v. Cavazos*, No. H89-182 (D. Conn. Jan. 10, 1990) (Slip Op.); *Delaware v. Cavazos*, 723 F. Supp. 234 (D. Del. 1989); *Georgia Student Finance Commission v. Cavazos*, No. 1:89-CV-160-MHS (N.D. Ga. filed Jan. 26, 1989); *Indiana v. Cavazos*, No. IP 89-125-C (S.D. Ind. Jan. 29, 1990) (Slip Op.) (reversing the Secretary's actions and remanding for further proceedings); *Iowa v. Bennett*, No. 88-142-B (S.D. Iowa filed March 15, 1988); *Maine State Board of Education v. Cavazos*, No. 88-0273-B (D. Me. filed November 23, 1988); *Massachusetts Higher Education Assistance Corp. v. Cavazos*, No. 89-1325-K (D. Mass. filed June 5, 1989); *Michigan Higher Education Authority v. Cavazos*, No. L89-400/8CA (W.D. Mich. filed Feb. 13, 1989); *Missouri Coordinating Board of Higher Education v. Cavazos*, No. 88-4576-CV-C9 (W.D. Mo. filed Dec. 15, 1988); *New Hampshire Higher Education Assistance Foundation v. Cavazos*, No. C88-4-56-D (D.N.H. filed Nov. 16, 1988); *Ohio Student Loan Commission v. Cavazos*, 709 F. Supp. 1411 (S.D. Ohio 1988), *reversed*, 900 F.2d 898 (6th Cir. 1990); *Puerto Rico Higher Education Assistance Authority v. Cavazos*, No. 89-3069-TFH (D.D.C. filed Nov. 9, 1989); *Rhode Island Higher Education Assistance Authority v. Cavazos*, No. 89-0015T (D.R.I. filed Jan. 9, 1989); *Education Assistance Authority v. Cavazos*, ___ F.2d ___, No. 89-5393 (8th Cir. Apr. 10, 1990) (South Dakota); *Tennessee Student Assistance Corp. v. Cavazos*, No. 389-0261 (M.D. Tenn. filed Dec. 28, 1989); *Virginia State Education Assistance Authority v. United States*, No. 88-0874-R (E.D. Va. filed Dec. 30, 1988); *Great Lakes Higher Education Corp. v. Cavazos*, 711 F. Supp. 485 (W.D. Wis. 1989), *appeal pending*, No. 89-2748 (7th Cir.).

Additionally, the issue of whether the states have protected property interests in monies they are owed or hold to administer programs regulated by federal law will likely affect numerous other programs. This issue will arise every time Congress attempts to resolve the federal government's fiscal problems by retroactively redefining private money as "excess cash reserves". For example, if § 1072(e) is constitutional, Congress may well decide that it can reduce the huge and growing cost of the savings and loan bailout by appropriating the "excess reserves" of healthy federally-regulated financial institutions.

The Constitution places limits on the admittedly broad powers of Congress to regulate federal programs. Here, Congress has exceeded those powers by taking private property in the guise of regulation. This Court should grant this petition to reaffirm the principle that the federal government cannot take private property without paying just compensation.

CONCLUSION

For the reasons stated, this Court should issue a writ of certiorari to review the judgment of the Fourth Circuit. Following review, that judgment should be reversed.

Respectfully submitted,

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UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

No. 89-2975

SOUTH CAROLINA STATE EDUCATION ASSISTANCE AUTHORITY

Plaintiff - Appellee

versus

LAURO F. CAVAZOS, etc., et al., in his official capacity as Secretary, United States Department of Education; U.S. DEPARTMENT OF EDUCATION

Defendants - Appellants

NATIONAL COUNCIL OF HIGHER EDUCATION LOAN PROGRAMS, INC.; VIRGINIA STATE HIGHER EDUCATION ASSISTANCE AUTHORITY

Amici Curiae.

No. 89-2978

SOUTH CAROLINA STATE EDUCATION ASSISTANCE AUTHORITY

Plaintiff - Appellee

versus

LAURO F. CAVAZOS, Secretary of Education; U.S. DEPARTMENT OF EDUCATION

Defendants - Appellants

NATIONAL COUNCIL OF HIGHER EDUCATION LOAN PROGRAMS, INC.; VIRGINIA STATE EDUCATION ASSISTANCE AUTHORITY

Amici Curiae

Appeals from the United States District Court for the District of South Carolina, at Columbia. Karen L. Henderson, District Judge. (CA-88-2710-16-3)

No. 89-2976

MARYLAND HIGHER EDUCATION LOAN CORPORATION, a nonprofit Maryland Corporation

Plaintiff - Appellee

versus

LAURO F. CAVAZOS, Secretary of the United States Department of Education

Defendant - Appellant

NATIONAL COUNCIL OF HIGHER EDUCATION LOAN PROGRAMS, INC.; VIRGINIA STATE EDUCATION ASSISTANCE AUTHORITY

Amici Curiae

Appeal from the United States District Court for the District of Maryland, at Baltimore. Frederic N. Smalkin, District Judge. (CA-89-270-S)

No. 89-2982

STATE OF NORTH CAROLINA; THE NORTH CAROLINA STATE EDUCATION ASSISTANCE AUTHORITY

Plaintiffs - Appellants

versus

UNITED STATES OF AMERICA; LAURO F. CAVAZOS, Secretary of the United States Department of Education; U.S. DEPARTMENT OF EDUCATION

Defendants- Appellees

NATIONAL COUNCIL OF HIGHER EDUCATION LOAN PROGRAMS, INC.; VIRGINIA STATE EDUCATION ASSISTANCE AUTHORITY

Amici Curiae

Appeal from the United States District Court for the Eastern District of North Carolina, at Raleigh. Terrence W. Boyle, District Judge. (CA 88-961-CIV-5)

Argued: October 3, 1989 Decided: March 7, 1990

Before RUSSELL, WIDENER, and HALL, Circuit Judges.

Affirmed in part, reversed in part, and remanded with instructions by published opinion. Judge Hall wrote the opinion, in which Judge Russell and Judge Widener joined.

Neil H. Koslowe, Special Litigation Counsel (Stuart E. Schiffer, Acting Assistant Attorney General; William Kanter, Deputy Director, Civil Division, DEPARTMENT OF JUSTICE; Edward C. Stringer, General Counsel; Harold Jenkins, Brian Seigel, Attorneys, DEPARTMENT OF EDUCATION, on brief) for Appellants. Andrew H. Baida, Assistant Attorney General (J. Joseph Curran, Jr., Attorney General; William F. Howard, Mary L. Preis, Assistant Attorneys General), on brief); James Emory Smith Jr. (Joseph D. Shine, Attorney General's Office; N. Bruce Holland, DEPARTMENT OF SOCIAL SERVICES, on brief); Thomas J. Ziko; Assistant Attorney General (Lacy H. Thornburg, Attorney General; Edwin M. Speas, Jr.,

Special Deputy Attorney General, on brief) for Appellees. (Jean Frohlicher, NCHELP, Inc.; George G. Olsen, Robert E. Jensen, WILLIAMS AND JENSEN, P.C., on brief) for Amicus Curiae NATIONAL COUNCIL OF HIGHER EDUCATION LOAN PROGRAMS, INC. (Mary Sue Terry, Attorney General; R. Claire Guthrie, Deputy Attorney General; Paul J. Forch, Senior Assistant Attorney General and Chief, Education Section; Richard C. Kast, Assistant Attorney General, on brief) for Amicus Curiae VIRGINIA STATE EDUCATION ASSISTANCE AUTHORITY.

HALL, Circuit Judge:

These consolidated appeals arise from actions filed by three different state-created agencies against the Secretary of the United States Department of Education ("Secretary") seeking to have certain portions of the 1987 amendments to the Higher Education Act of 1965 ("the Act") declared unconstitutional and to enjoin the Secretary from withholding payments to them in accordance with the amendments. In the South Carolina and Maryland cases, the district courts declared that the statutory provisions in question violated the Fifth Amendment's prohibition against the taking of private property without just compensation. The North Carolina court, however, upheld the statute's constitutionality. Finding that the amendments do not effect an unconstitutional taking, we reverse the South Carolina and Maryland judgments and remand for further proceedings. We affirm the judgment in the North Carolina case.

I.

A. Statutory Background

The Act established the Guaranteed Student Loan Program ("GSLP") to assist post-secondary school students. Under the GSLP, private lenders make low-interest loans,

subsidized by the federal government, to students. The lenders are insured by various state guaranty agencies that 100% of the unpaid principal of qualifying loans will be paid in case of default. Each state wishing to enable students to participate in the program must either establish its own guaranty agency or designate a private, non-profit agency to serve as such. This agency, in turn, must enter into written agreements with the Secretary by which it agrees to operate the program under GSLP guidelines. The Secretary is also authorized to enter into reinsurance agreements with the guaranty agencies by which the Secretary promises to reimburse between 80%-100% (depending on the agency's default rate) of the amounts expended by the guaranty agency in repaying the unpaid principal remaining on defaulted loans.

In addition to the reinsurance payments, the Secretary is authorized to make advances to enable a new agency to commence operation and administrative cost allowances to offset an agency's operating costs. Subject to statutory restrictions, a guaranty agency is also authorized to receive the following types of payments: (1) a single insurance premium on each loan (not to exceed 3% of the loan) which is paid by the lender and passed on to the student borrower; (2) a set portion of any amounts collected on defaulted loans for which the agency has received a reimbursement from the Secretary; (3) state appropriations; (4) gifts, grants and similar sources; and (5) investment earnings. Each guaranty agency is required to deposit these funds in a "reserve fund." 34 C.F.R. §682.410(a)(1). The reserve fund may only be used for those GSLP purposes specified by the Secretary, such as paying claims from lenders and administering the program, 34 C.F.R. §682.410(a)(2-6).

In response to concerns that these reserve funds had grown unnecessarily large, Congress enacted section 3001 of the Omnibus Budget Reconciliation Act of 1987, Pub. L. No. 100-203, 101 Stat. 1330-36 (the "1987 Amend-

ments"). These amendments required the Secretary to determine, using a statutory formula, the maximum allowable cash reserve for each guaranty agency. 20 U.S.C. §1072(e)(2). The Secretary was also required to direct any state agency with an excess to transfer such amount to the Secretary. 20 U.S.C. §1072(e)(2)(A)-(D). Any amounts recovered from the excess reserves were to be deposited into a student loan insurance fund which is used by the Secretary to make reimbursement payments under the GSLP. 20 U.S.C. §1081(a). The Secretary is also authorized to waive repayment of any excess for certain specified reasons. 20 U.S.C. §1072(e)(3).

B. The Instant Dispute

1. The guaranty agency in South Carolina is the South Carolina State Education Assistance Authority ("Authority"). This non-profit agency was created by statute in 1976 to administer the GSLP. Under the excess reserve formula, the Secretary established a cash reserve ceiling of $500,000 and required the Authority to transfer the excess ($2,739,528). The Secretary denied the Authority's request for a waiver of this transfer requirement. When the Authority refused to transfer any of the excess amount, the Secretary began withholding reinsurance payments otherwise payable and applying these withheld amounts toward the $2.7 million due.

In October 1988, the Authority filed an action against the Secretary challenging the constitutionality of the excess reserve and related enforcement provisions of the 1987 amendments. The Authority also challenged both the Secretary's computation of the excess amount under the statutory formula and his denial of its request for a waiver. On May 31, 1989, the district court declared that the statutory provisions authorizing the withholding of reimbursements violated the Fifth Amendment's Takings Clause because the Authority had acquired "vested property rights" in such payments. Accordingly, the court enjoined

any further withholding of reimbursement payments and ordered the Secretary to release any amounts withheld. *S.C. State Educ. Assistance Authority v. Cavazos*, 716 F. Supp. 886 (D.S.C. 1989). The Secretary appeals from this order.

2. The guaranty agency in Maryland is the Maryland Higher Education Loan Corporation ("MHELC"), a non-profit corporation established by statute in 1963. MHELC entered into GSLP agreements with the Secretary in 1965. Under the statutory formula, the Secretary determined that MHELC was required to transfer $10,797,400 of its reserve fund. The Secretary denied MHELC's waiver request, and the guaranty agency subsequently refused to voluntarily transfer the excess amounts of its reserve fund. After the Secretary began to withhold reimbursement payments, MHELC filed suit for declaratory and injunctive relief. Unlike the Authority, however, MHELC did not challenge the Secretary's computation of its excess, nor did it challenge the denial of a waiver. The district court adopted the reasoning of the South Carolina court and granted the relief sought by MHELC. *Md. Higher Educ. Loan Corp. v. U.S. Dept. of Educ.*, Civ. No. S-89-270 (D. Md. June 12, 1989). The Secretary's appeal followed.

3. The North Carolina State Education Assistance Authority ("NCSEAA") was created by the state in 1965 to administer a higher education loan program. In 1966, NCSEAA entered into the first of several agreements with the Secretary by which North Carolina agreed to participate in the GSLP. In 1988, the Secretary informed NCSEAA that it had an excess reserve of $15,911,946. Upon partial approval of NCSEAA's request for a waiver, this amount was reduced to $2,632,785. NCSEAA refused to transfer any of its excess to the Secretary and, as in the Maryland and South Carolina situations, the Secretary began to withhold reimbursement payments otherwise payable under the GSLP.

NCSEAA filed an action in district court challenging, *inter alia*, the constitutionality of the 1987 amendments' excess reserve provisions. On July 20, 1989, the district court upheld the constitutionality of the excess reserve amendments on the ground that the funds in question are public, rather than private, property and, as such, were not within the ambit of the Fifth Amendment's Takings Clause. Accordingly, the Secretary's motion for summary judgment was granted. *State of N.C. v. United States*, 725 F. Supp. 874 (E.D.N.C. 1989). NCSEAA appeals from this ruling.

II.

In each contract with the Secretary, the executory state agency agreed "to be bound by all changes in the Act or regulations in accordance with their effective dates." The regulations include a similar requirement. 34 C.F.R. §682.400(d). The South Carolina court cites *The Sinking Fund Cases*, 99 U.S. (9 Otto) 700 (1879), and *Bowen v. Agencies Opposed to Soc. Sec. Entrapment*, 477 U.S. 41 (1986), for the proposition that only an *express statutory* reservation in an act of the power to amend is effective to permit subsequent legislative alteration of agreements entered into by the federal government in conformity with such act. We do not read these cases so restrictively. In *Bowen*, although the power to amend was reserved in the authorizing legislation under which the agreements at issue were executed, the Court focused on the notice such express reservation provided to the state that the statute could be amended in the future. *Id.* at 53. Moreover, the Court in *Bowen* noted that the power to amend is deemed to have been reserved *unless* it is expressly relinquished. *Id.* at 52. As the Court noted, "contractual arrangements, including those to which a sovereign itself is party, 'remain subject to subsequent legislation' by the sovereign." *Id.* (quoting *Merrion v. Jicarilla Apache Tribe*, 455 U.S. 130, 147 (1982)). Accordingly, we find no merit in the agencies'

arguments that this power to amend was not reserved. *See also Great Lakes Higher Educ. Corp. v. Cavazos*, 711 F. Supp. 485, 494-96 (W.D. Wis. 1989); *State of Del. v. Cavazos*, 711 F. Supp. 234, 241-42 (D. Del. 1989). We turn, then, to the agencies' contentions that they had "vested property rights" which even a properly reserved power to amend could not reach.

III.

The constitutional provision at the core of these disputes is the Takings Clause of the Fifth Amendment: "[N]or shall private property be taken for public use, without just compensation." Simply stated, the state agencies contend that the transfer requirement of 20 U.S.C. §1072(e)(2) contravenes this constitutional provision because the agencies' reserve funds constitute "private property" accrued pursuant to contracts with the Secretary. We agree with the Secretary and the North Carolina district court, however, that the excess reserve funds are not "private property" within the meaning of the Takings Clause.

The essential aspects of private property are "free use, enjoyment and disposal," *Buchanan v. Warley*, 245 U.S. 60, 74 (1917), and the "right to exclude others," *Ruckelshaus v. Monsanto Co.*, 467 U.S. 986, 1011 (1984). As explained in *Ruckelshaus*, such property interests " 'are created and their dimensions are defined by existing rules or understandings that stem from an independent source such as state law' [citations omitted]." *Id.* at 1001. The nature of the loan program militates against a finding that the state agencies possessed such indicia of private ownership. As the North Carolina district court stated, "[i]f property comes within the control of the United States to such an extent that its use is ultimately under the direction of the United States, then it loses its character as 'private' property and becomes public to such an extent that it is not subject to a takings prohibition under the Fifth Amendment." *State of N.C. v. United States*, 725 F. Supp. at

876-77 (E.D.N.C. 1989). We agree that the regulations which completely control the reserve funds' uses are the sort of "existing rules or understandings" which prevent any of the guaranty agencies from acquiring an ownership interest in its reserve fund which would entitle it to protection as private property under the Takings Clause.

IV.

An alternative argument raised by the state agencies focuses not on the reserve fund itself as the property allegedly being taken but, rather, on the enforcement mechanism of the 1987 amendments which the state agencies claim acts to take their "vested contractual rights" to receive reimbursement payments. The South Carolina district court held that even if the power to amend had been effectively reserved, the contractual right to reimbursement payments had already vested in the Authority with regard to default payments already made. 716 F. Supp. at 794. The court's analysis proceeds from the principle that contractual rights are generally recognized to be property for purposes of the Takings Clause. *See, e.g., Lynch v. United States*, 292 U.S. 571, 579-80 (1934). Citing *The Sinking Fund Cases*, 99 U.S. at 719-21, the South Carolina court recognized that there exist some limits on the federal government's power to unilaterally amend its contracts and concluded that the 1987 Amendments had exceeded such limits. For a number of reasons, however, we believe that the state agencies' "contractual rights" to reimbursement payments had not "vested" so as to trigger Fifth Amendment protections.

The analysis of the vested/non-vested nature of the right to reimbursements is intertwined with the earlier discussion of the nature of the reserve funds themselves. The reserve funds are generated solely within the framework of a federal social welfare program involving students and prospective students throughout the nation. Just as the complete federal control over the use of the fund compels

the conclusion that the targeted funds do not constitute private property for Fifth Amendment purposes, the contractual right to reimbursement payments destined for inclusion in such reserve funds similarly is not the type of property subject to the "takings" prohibition. The reservation of the power to amend the terms of the GSL program prevents the participating state agencies from invoking the Fifth Amendment Takings bar against subsequent Congressional action. *Great Lakes Higher Educ. Corp.*, 711 F. Supp. at 495-96. The Court in *Bowen* emphasized that the sovereign authority to alter its contracts by subsequent legislation should not, if possible, be foreclosed and especially so in the context of a "comprehensive social welfare program." 477 U.S. at 52-53. We conclude that the public nature of the reserve funds themselves, coupled with the express contractual reservation of the power to amend the terms of the GSL program and the fact that the legislative changes involve a comprehensive federal/state social welfare program, forecloses a finding that the state agencies have obtained unalterable vested property rights to certain payments.

V.

For the foregoing reasons, the judgments in the South Carolina and Maryland cases are reversed and these cases are remanded for further proceedings consistent with this opinion. The judgment in the North Carolina case is affirmed.

Nos. 89-2975/76/78 - *REVERSED AND REMANDED*

Nos. 89-2982 - *AFFIRMED*

UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

No. 89-2975

SOUTH CAROLINA STATE EDUCATION ASSISTANCE AUTHORITY
Plaintiff - Appellee

v.

LAURO F. CAVAZOS, etc., et al., in his official capacity as Secretary, United States Department of Education; U.S. DEPARTMENT OF EDUCATION;
Defendants - Appellants

NATIONAL COUNCIL OF HIGHER EDUCATION LOAN PROGRAMS, INC.; VIRGINIA STATE EDUCATION ASSISTANCE AUTHORITY
Amici Curiae

No. 89-2976

MARYLAND HIGHER EDUCATION LOAN CORPORATION, a nonprofit Maryland Corporation
Plaintiff - Appellee

v.

LAURO F. CAVAZOS, Secretary of the United States Department of Education
Defendant - Appellant

No. 89-2978

SOUTH CAROLINA STATE EDUCATION ASSISTANCE AUTHORITY
Plaintiff - Appellee

v.

LAURO F. CAVAZOS, Secretary of Education; U.S. DEPARTMENT OF EDUCATION
Defendants - Appellants

No. 89-2982

STATE OF NORTH CAROLINA; THE NORTH CAROLINA STATE EDUCATION ASSISTANCE AUTHORITY
Plaintiffs - Appellants

v.

UNITED STATES OF AMERICA; LAURO F. CAVAZOS, Secretary of the United States Department of Education; U.S. DEPARTMENT OF EDUCATION
Defendants - Appellees

On Petitions for Rehearing with Suggestions for Rehearing In Banc

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The appellees South Carolina State Education Assistance Authority and Maryland Higher Education Loan Corporation and appellants State of North Carolina and North Carolina Education Assistant Authority's petitions for rehearing and suggestions for rehearing in banc were submitted to this Court. As no member of this Court or the panel requested a poll on the suggestions for rehearing in banc, and

As the panel considered the petitions for rehearing and is of the opinion that they should be denied,

IT IS ORDERED that the petitions for rehearing and suggestions for rehearing in banc are denied.

Entered at the direction of Judge Hall with the concurrence of Judge Russell and Judge Widener.

For the Court,

JOHN M. GREACEN
CLERK

FILED: MARCH 28, 1990

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MARYLAND

CIVIL NO. S-89-270

MARYLAND HIGHER EDUCATION LOAN CORPORATION

v.

UNITED STATES DEPARTMENT OF EDUCATION, *et al.*

ORDER AND DECLARATION

Upon consideration of plaintiff's and defendants' cross-motions for summary judgment and the oppositions thereto, IT IS, this 12th day of June, 1989, for reasons stated in a Memorandum Opinion, ORDERED, DECREED AND ADJUDGED:

1. That plaintiff's motion BE, and it hereby IS, GRANTED; and that defendants' motion BE, and it hereby IS, DENIED;

2. That plaintiff, Maryland Higher Education Loan Corporation (MHELC), has a statutory right to be reimbursed by defendants for money paid by MHELC to lenders of defaulted loans guaranteed by MHELC and reinsured by defendants prior to December 22, 1987;

3. That 20 U.S.C. § 1072(e) violates the Fifth Amendment to the United States Constitution and it is therefore null, void, and unenforceable;

4. That MHELC's reinsurance contracts with defendants remain in full force and effect according to their terms, unaffected by 20 U.S.C. § 1072(e), that MHELC is entitled to full reimbursement pursuant to the contracts as they existed on December 22, 1987, and that the defendant Department is not entitled to capture "excess cash reserves" under § 1072(e);

5. That defendants are permanently enjoined from enforcing § 1072(e) against MHELC; and

6. That the Clerk of Court mail copies of the foregoing Memorandum Opinion and of this Order and Declaration to counsel for the parties.

/s/
Frederic N. Smalkin
United States District Judge

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MARYLAND

CIVIL NO. S-89-270

MARYLAND HIGHER EDUCATION
LOAN CORPORATION

v.

UNITED STATES DEPARTMENT
OF EDUCATION, et al.

MEMORANDUM

This is a case brought by the Maryland Higher Education Loan Corporation, a non-stock, non-profit corporation organized under the Education Article of the Maryland Annotated Code, seeking declaratory and injunctive relief against the United States Department of Education, which it accuses of unconstitutionally interfering with its property and contractual rights under the Higher Education Act of 1965, as amended, 20 U.S.C. § 1071 *et seq.* In particular, the plaintiff is aggrieved by the enactment of a certain amendment to the Higher Education Act of 1965, contained in the Omnibus Budget Reconciliation Act of 1987, Pub. L. 100-203. The particular amendment in question, effective December 22, 1987, added subsection (e) to 20 U.S.C. §1072, authorizing the Secretary of Education to determine whether state loan administration bodies such as the plaintiff have excess cash reserves and, if so, to recapture such reserves by certain means, including refusal to make reinsurance payments on guaranteed loans which were in place prior to December 22, 1987. Pursuant to longstanding contracts with the United States Government, the plaintiff, a state agency guaranteeing loans made to students by lenders of first resort, is entitled to be

reimbursed by the federal government for losses in connection with student loans. (These losses, with respect to pre-December, 1987 loans, might not become evident for some time.) Thus, there is an active dispute between the parties as to the status of many millions of dollars which the defendants claim as excess cash reserves, and which the plaintiff does not want to give back. Plaintiff asserts that Congress had no right to force it to give the money up, or to penalize it for not doing so by authorizing the withholding of reinsurance payments in respect of pre-December, 1987 loans.* The parties have filed cross-motions for summary judgment, which have been fully briefed. No oral hearing is deemed necessary. Local Rule 6, D. Md.

This case raises constitutional issues that have been fully treated in the opinions of three United States District Courts. In *Ohio Student Loan Commission v. Cavazos*, Judge Graham, of the Southern District of Ohio, found the amendment in question unconstitutional, on a number of grounds fully described in his opinion. *Ohio Student Loan Commission v. Cavazos*, No. C-2-88-314 (S.D. Ohio 1988) to be reported at 709 F. Supp. 1411. On the other hand, Chief Judge Crabb, of the United States District Court for the Western District of Wisconsin, held that the statutory amendment in question is constitutional. *Great Lakes Higher Education Corp. v. Cavazos*, No. 88-C-159-C, 1989 WL 38578 (W.D. Wis. Apr. 14, 1989). The latest decision is that of Judge Henderson of the District of South Carolina. In *South Carolina State Education Assistance Authority v. Cavazos*, Civil No. 3-88-2710-16 (D.S.C. 1989), decided May 31, 1989, Judge Henderson held that the amendment in question is unconstitutional, because it works a taking of property without just compensation, in violation of the Fifth Amendment of the United States Constitution.

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* The statute provides for a waiver from the recapture/withholding process, but the plaintiff's request for a waiver was denied by the defendants.

Having weighed and considered the issues in light of the authorities cited above, and the authorities cited within those authorities, this Court has reached the conclusion that the amendment in question is unconstitutional, as a prohibited taking of the plaintiff's property by the United States Government, without just compensation. Because this Court could not improve upon the excellent analysis embodied in Judge Henderson's opinion in the *South Carolina* case, the Court hereby incorporates and adopts that opinion as its reasons for decision in this case. (A copy of Judge Henderson's opinion is attached hereto). In a nutshell, the excess cash reserves are the property of the plaintiff, and, despite language making the plaintiff's contract with the defendants conformable to legislative changes, the federal government cannot simply take the cash reserves away from the plaintiff, especially through the vehicle of reneging on its obligation to reimburse for losses experienced by plaintiff in connection with previously guaranteed loans.

For the reasons stated, an order will be entered separately, granting the plaintiff's motion for summary judgment, and decreeing the appropriate relief.

/s/
Frederic N. Smalkin
United States District Judge

Dated: June 12, 1989

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF SOUTH CAROLINA
COLUMBIA DIVISION

CIVIL ACTION NO. 3:38-2710-16

SOUTH CAROLINA STATE EDUCATION ASSISTANCE AUTHORITY,

Plaintiff,

v.

LAURO F. CAVAZOS, in his official capacity as Secretary, United States Department of Education, and UNITED STATES DEPARTMENT OF EDUCATION,

Defendants.

ORDER

I.

This matter is before the Court on cross motions for summary judgment pursuant to Fed. R. Civ. P. 56. All parties agree that no issue of material fact exists and that this matter should be resolved as a matter of law. For the reasons set forth below, the Court grants the plaintiff's motion for summary judgment and denies the defendants' motion.

The South Carolina State Education Assistance Authority ("Authority") is a non-profit agency that guarantees student loans under the federal Guaranteed Student Loan Program ("GSLP"). The GSLP is the largest federal program providing financial assistance to students seeking a post-secondary education. Under the GSLP, various lenders such as commercial banks and savings and loan institutions make low-interest loans to students. The loans are subsidized by the federal government and are further pro-

tected by guarantees made by fifty-eight state or private, non-profit agencies. These guarantors are reinsured by the United States Department of Education ("DOE"). The Authority is one such guarantor.

The Authority is the middleman of the GSLP, serving as the link between the lender and the DOE. It collects premiums from lenders (who pass on the premium cost to loan recipients) in exchange for its agreement to repay loans in default due to death, disability, bankruptcy or default of the borrower. When a default occurs the lender files a claim with the Authority and the Authority pays the claim. The Authority attempts to collect from the borrower the loan on which it has paid the default claim. The Authority also encourages program participation and verifies that lenders exercise due diligence. In addition to the premiums collected from lenders, the Authority is also funded by federal advances, federal administrative cost allowances and federal reinsurance payments; collections on defaulted loans; state appropriations; investments; and other sources.

The DOE administers the GSLP nationwide. It has numerous functions including the oversight of the operations of the lenders and guaranty agencies. The DOE makes subsidized interest and special allowance payments directly to the lenders and it reinsures the guarantees issued by the guaranty agencies. If a guaranty agency pays a lender's default claim, and both have exercised due diligence, the DOE makes a reinsurance payment to the guaranty agency. The DOE also reimburses the guaranty agency for a portion of its administrative costs and provides advances to help it maintain adequate cash reserves for claims and other expenses. The relationship between the DOE and a guaranty agency is set forth in written agreements which are governed by certain federal statutes.

Under the Higher Education Act of 1965, 20 U.S.C. §§1071 *et seq.* ("the Act"), as amended in 1986, guaranty

agencies are required to insure one hundred percent of the loan amounts for which they issue guarantees. 20 U.S.C. §1078(b)(1)(G). The DOE, in turn, must reimburse one hundred percent of the amount expended by the agencies under its reinsurance obligations unless their claims rate exceeds a certain level. The 1986 amendments to the Act expressly grant "a contractual right" to guaranty agencies "as against the United States" to receive reinsurance payments and administrative cost allowances from the DOE. Higher Education Amendments of 1986, Pub. L. No. 99-498, § 402(a), 100 Stat. 1268, 1376.

Congress became concerned about the federal costs associated with the program in 1986 and considered numerous amendments to reduce costs. Even as Congress worried about the federal costs, some state and private guarantors apparently were accumulating large surpluses in their reserve funds.[1] As a result of Congress's concern, the United States Comptroller General made numerous recommendations for reducing the federal costs attending the GSLP.

This action arises out of one of the Comptroller's recommendations accepted by Congress and included in the Omnibus Budget Reconciliation Act of 1987, Pub. L. No. 100-203, 101 Stat. 1330-36 ("1987 amendments"), which was enacted on December 22, 1987 and will expire on September 30, 1989. The critical amendment establishes a cap on the amount of "excess reserves" that a guaranty agency may keep on hand and attempts to recoup all reserves beyond that cap. The 1987 amendments establish a formula, now codified at 20 U.S.C. §1072(e)(1), for determining the maximum amount of funds a guaranty agency may accumulate in its reserve fund.

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[1] The term "reserves" is not defined in the Act or the DOE regulations. It refers to the reservoir of funds held by a guaranty agency for future contingencies, and it represents the cumulative amount of money available when the agency's total expenditures are subtracted from its total revenue.

Under 20 U.S.C. §1072(e)(2) the DOE Secretary must direct an agency whose cash reserves exceed the ceiling to "eliminate" the excess by (1) repaying advance payments that are not otherwise due; (2) withholding and cancelling reimbursement claims that are otherwise payable; (3) reducing the amount to be claimed for administrative costs; (4) paying an additional reinsurance fee; or (5) adopting any other acceptable method of reducing payments from or increasing payments to the federal government. The recovered amounts are deposited in the student loan insurance fund established by 20 U.S.C. §1081(a) and are used exclusively for GSLP purposes.

The 1987 amendments authorize the Secretary to waive the requirements of 20 U.S.C. § 1072(e)(2) under an administrative appeals procedure. A waiver may be granted if an agency would be compelled to violate contractual obligations existing on December 22, 1987, that require a specific level of cash reserves. A guaranty agency must apply for a waiver and the Secretary must respond in an expedited manner.

The 1987 amendments also modify the provisions granting the guaranty agency a "contract right" to reinsurance payments, administrative cost allowances and advances by making them subject to the cash reserve ceiling provisions. The amendments provide that a guaranty agency "shall, *subject to section 1072(e) of this title* [*the cash reserve ceiling provisions*], be deemed to have a contractual right against the United States" to receive reimbursement for losses on insured loans. Similarly, the amendments provide that a guaranty agency "shall, *subject to section 1072(e) of this title*, be deemed to have a contractual right against the United States" to receive administrative cost allowances. Thus, although the Act had earlier expressly granted to the guaranty agency contractual rights to reinsurance reimbursements and administrative cost allowances, the 1987 amendments now make these rights contingent on the size of the agency's reserves.

On February 9, 1988, the Secretary notified the Authority that it had $2,739,528 in excess cash reserves and that it was required to eliminate the excess by one of the statutorily prescribed methods. Since that date the Authority has continued to submit requests for reinsurance and administrative cost reimbursements to the Secretary and the Secretary has refused to honor those requests. The reinsurance payments now being withheld relate to loans guaranteed by the Authority prior to enactment of the 1987 amendments. The Authority applied for a waiver on the ground that it would be compelled to violate contractual obligations existing on December 22, 1987, if the 1987 amendments were applied to it but the Secretary denied the application. The Authority sued the DOE on October 17, 1988.[2] The parties have stipulated that the amount in controversy is $2,657.87.[3]

The Authority advances seven causes of action. In the first two causes of action it contends that the 1987 amend-

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[2] At least three other district courts have issued rulings in virtually identical actions. In *Great Lakes Higher Education Corp. v. Cavazos*, No. 88-C-159-C (W.D. Wis. April 17, 1989), the District Court for the Western District of Wisconsin denied the plaintiff's motion for a preliminary injunction to enjoin the DOE from withholding reimbursement payments from the plaintiff because the plaintiff had an adequate remedy at law. The court in *Great Lakes* later granted summary judgment in favor of the DOE, discussed in greater detail, *infra*. The District Court for the Eastern District of Virginia likewise refused to grant the plaintiff temporary injunctive relief in *Virginia State Education Assistance Authority v. Cavazos*, No. 88-0874-R (E.D. Va. Jan. 10, 1989). In *Ohio Student Loan Comm'n v. Cavazos*, No. C-2-88-0314 (S.D. Ohio Dec. 19, 1988), the court held that the amendments are unconstitutional on several different grounds. On March 10, 1989, it issued an additional order rejecting new arguments of the plaintiff. The Sixth Circuit recently stayed the district court's order. *Ohio Student Loan Comm'n v. Cavazos*, No. 89-3168 and No. 89-3238 (6th Cir. filed May 23, 1989).

[3] Although the defendants have claimed $2,739,528 from the Authority, the Authority has agreed to pay $81,841 of this sum which, when deducted, leaves $2,657,687 as the amount in controversy.

ments constitute a "taking" without compensation of its property rights in its contracts with the defendants and in its cash reserve fund in violation of the fifth amendment to the United States Constitution.[4] In the third cause of action, the Authority contends the 1987 amendments arbitrarily distinguish between guaranty agencies with excess cash reserves and those without cash reserves in violation of the equal protection clause of the fourteenth amendment to the United States Constitution. In the fourth cause of action, the Authority contends that the amendments breach its contracts with the defendants. In the fifth cause of action, the Authority contends the Secretary erroneously calculated the amount of its excess cash reserves in violation of the 1987 amendments. In the sixth cause of action, the Authority contends that elimination of its excess cash reserves would cause it to violate contractual obligations contrary to one of the provisions in the 1987 amendments. In the seventh cause of action, the Authority contends that the 1987 amendments call into question the validity of public debt in violation of section four of the fourteenth amendment to the United States Constitution.[5]

The Authority seeks both declaratory and injunctive relief. It seeks a declaration that the 1987 amendments are unconstitutional, that the defendants miscalculated the amount of its excess cash reserves and that the defendants erroneously failed to grant it a waiver of the requirements imposed by the 1987 amendments. The Authority also seeks to enjoin the defendants from offsetting amounts owed by the federal government against its debt under the 1987 amendments.

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[4] U.S. Const. amend. V provides in part that "private property [shall not] be taken for public use, without just compensation."

[5] U.S. Const. amend. XIV, §4 provides in part: "The validity of the public debt of the United States, authorized by law, . . . shall not be questioned."

The Authority originally moved for a preliminary injunction but that motion was withdrawn; both the Authority and the defendants have now moved for summary judgment on all issues.

II.

As noted earlier, Congress in 1986 expressly granted to the Authority a contractual right to receive the reinsurance reimbursement and the administrative cost allowances. Higher Education Amendments of 1986, Pub. L. No. 99-498, § 402(a), 100 Stat. 1268, 1376. Congress then made the contractual rights subject to the 1987 amendments regarding limits on excess reserves. The Authority argues that Congress cannot relieve itself retroactively of its contractual obligations; on the other hand, the defendants argue that Congress is authorized to alter its obligations under this program.

The arguments on both sides revolve primarily around *Bowen v. Public Agencies Opposed to Social Security Entrapment*, 106 S.Ct. 2390 (1986), and the *The Sinking Fund Cases*, 99 U.S. (9 Otto) 700 (1879). In *The Sinking Fund Cases* Congress attempted to amend contracts the federal government had entered into with certain railroad companies. According to the contracts, Congress provided land to the railroads and entered into an agreement requiring the railroads to provide full payment for the land in thirty years. The railroads agreed to furnish the government with transportation and telegraph transmissions on a preferential basis and to set aside toward payment of the principal and interest due on the subsidy bonds issued by Congress to finance railroad expansion fifty percent of the compensation due for these services plus five percent of annual net earnings. Apparently, the railroad companies accumulated more debt in extending the railroads than Congress had anticipated; despite the accumulation of debt, however, the railroads declared dividends rather than setting aside money for repayment of the subsidy bonds.

Fearing that the railroads would not have enough to pay the substantial debt when it came due, Congress amended the legislation to require that the government apply one hundred percent of the compensation due the railroads to the other sources (one-half to interest debt on the subsidy bonds and the other half invested in United States bonds in a sinking fund established in the United States Treasury). The railroads were also required to pay twenty-five percent of their earnings into the sinking fund. Proceeds of the sinking fund were to be used to pay all remaining interest and principal due on the subsidy bonds on the date of their maturity.

The United States Supreme Court held that the amendments did not deprive the railroads of due process.[6] The Court first noted that Congress, in the original legislation, had expressly reserved the right to amend the legislation. 99 U.S. at 719-20. The Court declared, "It is unnecessary to decide what power Congress would have over the charter if the right of amendment had not been reserved; for as we think, that reservation has been made." *Id.*

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[6] Before beginning its analysis, the Court noted that the United States is "prohibited from depriving persons or corporations of property without due process of law." 99 U.S. at 501. Whether the *The Sinking Fund* cases are pure "due process" cases or whether the Court's analysis applies equally well to fifth amendment "taking without just compensation" and fourteenth amendment "questioning of the public debt" cases is unclear. Mr. Chief Justice Waite described the issue as whether the amended statute "deprives the Company of its property without due process of law, *or in any other way improperly interferes with vested rights.*" *Id.* (emphasis added). Moreover, other decisions addressing similar facts have loosely referred to the *The Sinking Fund Cases* both as taking cases, *see Bowen v. Public Agencies Opposed to Social Security Entrapment* 477 U.S. 41, 48 (1986), and as questioning of the debt cases, *see Perry v. United States*, 294 U.S. 330, 354 (1934). Based on *Bowen* as well as on the breadth of the *The Sinking Fund Cases* holding itself this Court views *The Sinking Fund Cases* language establishing limits on legislation that alters the United States' contractual obligations as based not only on the due process clause of the fifth amendment but also on the taking clause of that amendment.

Next, the Court noted numerous factors underlying its decision: (1) the railroads had been paying money in dividends rather than preparing to pay a certain, and large, debt to the government; (2) the government was both a sovereign and a creditor, and "[t]heir rights as sovereign are not crippled because they are creditors, and their privileges as creditors are not enlarged by the charter because of their sovereignty," *id.* at 724; and (3) "The original contracts of loan are not changed. They remain as they were before, and are only to be met at maturity. All that has been done is to make it the duty of the Company to lay by a portion of its current net income to meet its debts when they do fall due." *Id.* at 725.

The Court in *The Sinking Fund Cases*, however, used strong language in setting the outer limits of Congress's authority to alter its contractual obligations:

> [Congress] cannot legislate back to [itself], without making compensation, the lands they have given this Corporation to aid in the construction of its railroad. Neither can they by legislation compel the Corporation to discharge its obligations in respect to the subsidy bonds otherwise than according to the terms of the contract already made in that connection. The United States are as much bound by their contracts as are individuals. If they repudiate their obligations, it is as much repudiation, with all the wrong and reproach that term implies, as it would be if the repudiator had been a State or a municipality or a citizen. No change can be made in the title created by the grant of the lands, or in the contract for the subsidy bonds, without the consent of the corporation. All this is indisputable.

99 U.S. at 719.

In addition, the Court decided that, even if Congress expressly retains authority to amend its contracts in the

legislation authorizing the contracts, it cannot take away benefits already conferred under the contracts:

> That this power [to alter obligations under a contract by amending authorizing legislation] has a limit, no one can doubt. All agree that it cannot be used to take away property already acquired under the operation of the charter, or to deprive the Corporation of the fruits actually reduced to possession of contracts lawfully made. . . .
>
> . . . [W]hatever rules Congress might have prescribed in the original charter for the government of the Corporation in the administration of its affairs, it retained the power to establish by amendment. In so doing it cannot undo what has already been done, and it cannot unmake contracts that have already been made, but it may provide for what shall be done in the future, and may direct what preparation shall be made for the due performance of contracts already entered into.

Id. at 720-21.

The United States Supreme Court addressed a similar issue in *Bowen v. Public Agencies Opposed to Social Security Entrapment*, 477 U.S. 41 (1986). The issue there was whether, by amending the social security legislation, Congress could deprive a state of the prerogative originally granted in that statute and in an agreement tracking the statutory language to withdraw from the social security program. The Court held that Congress had in the original act reserved the power to amend it and could so amend it because the act itself created no property right under the fifth amendment. The Court observed that "[t]he State accepted the Agreement under an Act that contained the language of reservation. That language expressly notified the State that Congress retained the power to amend the law under which the Agreement was executed and by

amending that law to alter the Agreement itself." *Id.* It continued, "Congress does not have the power to repudiate its own debts, which constitute 'property' to the lender, simply in order to save money," but the section of the social security act at issue was neither a debt of the United States nor an obligation of the United States to provide benefits under a contract for which the obligee paid a monetary premium, and hence did not rise to the level of a protected property right. *Id.* at 55.

Thus, under *The Sinking Fund Cases* and *Bowen*, Congress can alter its agreements if it expressly retains that right in the legislation under which agreements are entered into. As a limit on that rule, however, the United States Supreme Court has made clear that Congress cannot "unmake" contracts in which the other party has acquired a property right, even if it has retained the authority to amend the legislation and thereby the contracts. The first question here, then, is whether the Authority has acquired a property right in the contracts it entered into with the Secretary pursuant to the Higher Education Act before the 1987 amendments. If the Authority has a property right under the contracts to receive reimbursement for guaranty payments and administrative cost allowance, Congress cannot empower the defendants to take away that property right without either the Authority's consent or just compensation.

In *White v. United States*, 270 U.S. 175 (1926), and *Lynch v. United States*, 292 U.S. 571 (1934), the United States Supreme Court established guidelines for determining when a party to a contract with the federal government has an enforceable property right in the contract. In *White* a soldier purchased a life insurance policy from the government and named his mother and his aunt as beneficiaries of one-half of the proceeds each. When he entered into the contract, the statute providing the insurance did not list "aunts" as allowed beneficiaries. Before he died the statute was amended to include aunts as be-

neficiaries. Later, after the insured died, his mother contended that she was entitled to the full proceeds because the amendment could not constitutionally alter the terms of the statute in effect when her son purchased the insurance. The certificate of insurance provided that it was " 'subject in all respects to the provisions of such Act, of any amendments thereto, and of all regulations thereunder, now in force or hereafter adopted, all of which, together with the application for this insurance, and the terms and conditions published under authority of the Act, shall constitute the contract.' " *White*, 270 U.S. at 180. The Court ruled against the mother, basing its decision on the facts that the policy was a contract between the deceased and the government, it was expressly subject to changes in the governing statute and the insured's mother could have acquired no rights under the contract until the son died, which occurred after the amendment to the statute. Because the plaintiff (the mother) was not a party to the contract and her interest could not have vested until after the amendment was enacted, the issue presented and decided was a standing issue, that is, "one whose vested rights were not thereby disturbed could not complain of subsequent legislation affecting the terms of the policy." *Lynch*, 292 U.S. at 577. The questions left unanswered by *White* include when a party's rights are considered vested and, if vested, when they can be divested by subsequent legislation.

Lynch assisted in answering these questions. There, beneficiaries under government-issued life insurance policies claimed that Congress unconstitutionally repealed the act providing for the policies after having issued and accepted premiums for the policies. The Court declared, apparently on both due process and taking without compensation grounds, that the amendment disavowing the insurance policies was unconstitutional:

> The repeal, if valid, abrogated outstanding contracts; and relieved the United States from all

> liability on the contracts without making compensation to the beneficiaries.
>
> . . . The Fifth Amendment commands that property be not taken without making just compensation. Valid contracts are property, whether the obligor be a principality, a State or the United States. Rights against the United States arising out of a contract with it are protected by the Fifth Amendment.
>
> . . .
>
> In the administration of all government business economy had become urgent because of lessened revenues and the heavy obligations to be issued in the hope of relieving widespread distress. Congress was free to reduce gratuities deemed excessive. But Congress was without power to reduce expenditures by abrogating contractual obligations of the United States. To abrogate contracts, in the attempt to lessen government expenditure, would not be the practice of economy, but an act of repudiation.

Id. at 579-80.[7]

Significantly, the original act in *Lynch* did not include language reserving to the government the right to alter the contracts entered into under the statute by amendment, unlike the legislation in *The Sinking Fund Cases* and in *Bowen*. The contracts of insurance themselves, however, stated that the policy "should be subject to all amendments to the original Act, to all regulations then in force or thereafter adopted." *Id.* The policy form in which this language appeared was prepared by the Veterans Administration. The Court nevertheless concluded that "no power to curtail the amount of the benefits which Congress

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[7] *See id.* at 579 (for due process discussion); *see infra* n.9.

contracted to pay was reserved to Congress; and none could be given by any regulation promulgated by the Administrator." *Id.* at 578. In this Court's view, *Lynch* manifests that language reserving to Congress the power to amend legislation and contracts entered under it must be in the legislation itself to be effective.

The defendants argue, however, that no property right vested in the Authority because the Secretary included, in the regulations issued pursuant to the Higher Education Act and in the contracts between the Authority and the DOE, language reserving to Congress the right to amend the contracts. The defendants rely on the Supreme Court's language in *Bowen* that the provision of the legislation at issue there "simply cannot be viewed as conferring any sort of 'vested right' in the face of precedent concerning the effect of Congress' reserved power on agreements entered into under a statute containing the language of reservation." *Bowen*, 477 U.S. at 55. The Court concluded, therefore, that "[s]ince appellees had no property right in the termination clause, [the statute] did not effect a taking within the meaning of the Fifth Amendment." *Id.* at 55-56.

On the basis of this language the defendants argue that the Authority could not possess a property right in its contracts with the federal government because of the notice of Congress's ability to amend the Higher Education Act contained in the Secretary's regulations and in the contracts. Indeed, a recent opinion supports the defendants' reading of *Bowen*. In *Great Lakes Higher Education Corp. v. Cavazos*, No. 83-C-159-C (W.D. Wis. April 17, 1989), the court interpreted *Bowen* to mean that "a contractual right arising out of a contract governed by an act subject to the express reservation of Congress's power to amend is not a right that constitutes property protected by the Fifth Amendment." *Id.* at 21.

This Court does not agree with the defendants' argument or with the ruling in *Great Lakes*. First, such a reading of *Bowen* disregards the development of the law in this area beginning with *The Sinking Fund Cases*. In *The Sinking Fund Cases* the Supreme Court expressly declared that, regardless of whether Congress reserves the power to amend an agreement made pursuant to a statute by amending the statute, Congress's power to amend an agreement has limits, as this Court earlier discussed, *supra*. If, as the defendants contend, a party to a contract with the federal government under these circumstances does not possess a property right in its contract with the government, then, contrary to *The Sinking Fund Cases*, the power of Congress to alter its obligations under a contract containing a reservation of power to amend would be effectively unlimited because no party to that contract could ever acquire a property right to the benefits due under the contract. Faith in contracts with the government would be seriously shaken by such a ruling.

The defendants' and *Great Lakes*'s reliance on *Bowen*, however, is misplaced. First, unlike the reservation of Congress's power in the *Bowen* legislation, the reservation of power to amend the contracts made under the Higher Education Act is contained not in the Act, but instead only in the regulations issued by the Secretary and in the contracts themselves.[8] *Lynch* makes clear the significance of this distinction in holding that a reservation of power to amend the act in question contained only in the regulations promulgated under the act and in the insurance contract authorized by the act but not in the act did not reserve to Congress amendatory power. As noted earlier,

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[8] The agreements expressly provide that the Authority "shall be bound by all changes in the Act or Regulations in accordance with their effective dates." Complaint, Exhibit B, ¶1. The Secretary's regulations similarly provide that all agreements are "subject to subsequent changes in the Act or the regulations that apply to the [GSL] Program." 34 C.F.R. 682.400(d).

the Supreme Court held that "no power to curtail the amount of the benefits which Congress contracted to pay was reserved to Congress; and none could be given by any regulation promulgated by the Administrator." *Lynch*, 292 U.S. at 578. Applying this language here, this Court concludes that the Secretary cannot in his regulations reserve to Congress the power to amend its contracts with the Authority by amending the statute under which the contracts were entered into; only Congress can do that. Nor can such power be created by a term in the contract between the Secretary and the Authority. Nonetheless the defendants argue that, because notice of reservation is included in the contract and because the Authority is more likely to read the contract than the statute, the notice here is sufficient. The issue, however, is not notice; the issue is whether Congress reserved the *power* to amend the contract. Here, it did not, and the notice provisions in the contract and in the regulations cannot grant such power.

Accordingly, the Court concludes that here, as in *Lynch*, the Authority has vested property rights in its contracts with the United States to receive reimbursement for payments made to guarantee defaulted loans and to receive advances and administrative cost allowances. As in *Lynch*, the Authority is a party to the contract and has paid valuable consideration for its right to receive reinsurance payments, administrative cost reimbursements and advances—it has agreed to guarantee the loans and it has administered the GSLP on the state level, acting as the middleman between the federal government and the lending institutions. Furthermore, Congress expressly provided in the 1986 amendments that the Authority has a "contractual right" to receive reinsurance payments and administrative cost allowances. This Court rejects the reasoning in *Great Lakes* that these rights could not vest, and instead finds that the Authority's rights constitute property. Because they do constitute property, then, even

if a reservation of power to amend the contracts were contained in the legislation authorizing them, Congress could not by amending the legislation take away that property. *The Sinking Fund Cases*, 99 U.S. at 720.

This Court further rejects the defendants' argument that they may withhold these payments as a means of enforcing the requirement in the 1987 amendments that the Authority reduce its excess cash reserves. The defendants contend that the federal government regularly withholds funding for certain programs in order to assure compliance with certain policies and that the withholding of reinsurance payments here is no different. Here, however, the requirement that the Secretary is attempting to enforce is itself not binding on the Authority. "The United States are as much bound by their contracts as are individuals." *Id.* at 719. Thus, just as the Authority could not unilaterally require the Secretary to pay it additional consideration to continue its role in the GSLP, the Secretary cannot unilaterally require the Authority to pay ransom in order to continue receiving both reimbursements for monies already paid out and administrative cost allowances and advances in accordance with the contract.

Finally, there is no difference of legal significance among the prescribed methods the defendants are authorized to use to enforce the 1987 amendments. Regardless of the means chosen to attempt to force the Authority to comply with the requirements of the 1987 amendments, any attempt to coerce its compliance without just compensation constitutes an unconstitutional taking of the Authority's property rights in its contracts with the federal government under the fifth amendment to the United States Constitution and is therefore unconstitutional.

III.

Accordingly, the Court declares that the 1987 amendments authorize the taking of the Authority's property

without just compensation in violation of the fifth amendment to the United States Constitution and are unconstitutional.[9] The Secretary is enjoined from offsetting the Authority's excess cash reserves against future reinsurance payments or other federal payments to which the Authority would otherwise be entitled pursuant to its contracts with the United States. The defendants are ordered to release to the Authority the funds which they have wrongfully withheld within thirty days of the date this order is filed.

IT IS SO ORDERED.

/s/
KAREN LeCRAFT HENDERSON
UNITED STATES DISTRICT JUDGE

Columbia, South Carolina
May 31, 1989

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[9] Because the Court finds the 1987 amendments violate the fifth amendment proscription against taking property without just compensation, it does not reach the Authority's claims that the amendments violate the due process clause of the fifth amendment, the equal protection clause of the fourteenth amendment and the questioning of the public debt clause of the fourteenth amendment. The Court also does not reach the Authority's allegations that the Secretary miscalculated its excess reserves and that he erroneously failed to grant a waiver to the Authority.

UNITED STATES CONSTITUTION, AMENDMENT V

No person shall be held to answer for a capital, or otherwise infamous crime, unless on a presentment or indictment of a Grand Jury, except in cases arising in the land or naval forces, or in the Militia, when in actual service in time of War or public danger; nor shall any person be subject for the same offence to be twice put in jeopardy of life or limb; nor shall be compelled in any criminal case to be a witness against himself, nor be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation.

20 U.S.C. § 1078(c)(1)(A) (1986 Supp.)

(c) Guaranty agreements for reimbursing losses

(1) Authority to enter into agreements

(A) The Secretary may enter into a guaranty agreement with any guaranty agency, whereby the Secretary shall undertake to reimburse it, under such terms and conditions as the Secretary may establish, with respect to losses (resulting from the default of the student borrower) on the unpaid balance of the principal and accrued interest of any insured loan, including the administrative costs of supplemental preclaim assistance for default prevention as defined in paragraph (6)(C). The guaranty agency shall be deemed to have a contractual right against the United States, during the life of such loan, to receive reimbursement according to the provisions of this subsection. Upon receipt of an accurate and complete request by a guaranty agency for reimbursement with respect to such losses, the Secretary shall pay promptly and without administrative delay. Except as provided in subparagraph (B) of this paragraph and in paragraph (7), the amount to be paid a guaranty agency as reimbursement under this subsection shall be equal to 100 percent of the amount expended by it in discharge of its insurance obligation incurred under its loan insurance program. In no case shall a guaranty agency file a claim under this subsection for reimbursement with respect to losses prior to 270 days after the loan becomes delinquent with respect to any installment thereon.

PUB. L. NO. 100-203, 101 STAT. 1330-36

SEC. 3001. RECOVERY OF EXCESS CASH RESERVES ACCUMULATED UNDER THE GUARANTEED STUDENT LOAN PROGRAM

(a) IN GENERAL—Section 422 of the Higher Education Act of 1965 (20 U.S.C. 1072) is amended by adding at the end thereof the following new subsection:

"(e) REDUCTION OF EXCESS CASH RESERVES.—

"(1) LIMITATION ON MAXIMUM CASH RESERVES—A guaranty agency shall not accumulate cash reserves in excess of the greater of—

"(A) 40 percent of the total amount paid by that agency on insurance claims during the preceding fiscal year;

"(B) 0.3 percent of original principal amount of loans that are insured by that agency and that are outstanding at the end of such preceding fiscal year;

"(C) an amount which, when combined with all other parts of total agency reserves, equals 0.4 percent of such original principal amount;

"(D) $500,000; or

"(E) the amount required to comply with the reserve requirements of a State law as in effect on October 17, 1986.

"(2) RECOVERY OF EXCESS CASH RESERVES.—The Secretary shall, not later than March 31, 1988, determine for each guaranty agency the maximum cash reserve permitted under paragraph (1) for fiscal year 1986. Subject to paragraphs (3) and (4), if the Secretary determines that any guaranty agency had, at the end of fiscal year 1986, a cash

reserve that exceeded such maximum, the Secretary shall direct the agency to eliminate such excess by any one or more of the following methods, as selected by the guaranty agency:

"(A) by repaying any advances to such agency made by the Secretary under this section that are not required to be repaid under subsection (d);

"(B) by withholding and canceling claims for reimbursement otherwise payable under section 428(c)(1);

"(C) by reducing the amount of payments for which application will be made by such agency under section 428(f); or

"(D) by any other method of reducing payments from or increasing payments to the Federal Government, including payment of additional reinsurance fees in addition to the fees required by section 428(c)(9), as proposed by the agency and agreed to by the Secretary.

"(3) APPEALS BASED ON SPECIAL CIRCUMSTANCES.—(A) If the Secretary determines, on the basis of an application from a guaranty agency, that—

"(i) the agency's financial position has deteriorated significantly since the end of the preceding fiscal year;

"(i) significant changes in the economic circumstances (such as a change in agency current cash reserves) or the loan insurance program render the limitations of paragraph (1) inadequate for the continued functioning of the agency; or

"(iii) in recovering funds as required by this subsection, a guaranty agency would be compelled to violate contractual obligations existing on the date

of enactment of this subsection that require a specified level of reserve funds to be maintained by such agency;

the Secretary may waive, in whole or in part, the imposition of the remedies required by paragraph (2) for such agency.

"(B) The Secretary shall respond to request for waivers from guaranty agencies in an expedited manner and, except for unusual circumstances or with the consent of the guaranty agency, shall resolve such request within 6 weeks of submission.

"(4) RECOVERY LIMITS. - The Secretary shall not require a total reduction of cash reserves for all guaranty agencies in excess of $250,000,000 during fiscal year 1988. If the total of cash reserves of all guaranty agencies exceeds the maximum amounts permitted under paragraph (1) by more than $250,000,000, the Secretary shall ratably reduce the amounts that guaranty agencies are directed to eliminate under paragraph (2), so that the total excess cash reserves to be eliminated equals $250,000,000.

"(5) DEFINITIONS.—As used in this subsection—

"(A) the 'cash reserves' for any guaranty agency for any fiscal year are equal to the agency's cumulative cash receipts less the agency's cumulative cash disbursements at the end of such fiscal year;

"(B) the 'total reserves' for any guaranty agency for any fiscal year are equal to the agency's cash reserves plus the agency's cumulative accounts receivable less the agency's accounts payable, as of the end of such fiscal year;

"(C) the term 'cumulative cash receipts' includes such receipts as insurance premiums, Federal reinsurance payments, and collections on defaulted loans;

"(D) the term 'cumulative cash disbursements' includes such disbursements as payments for default claims, repayment of Federal advances, transfers to other State activities, and payment of collection costs and other operating costs;

"(E) the term 'accounts receivable' includes Federal reinsurance payments and administrative cost allowances owed but not yet paid to the guaranty agency, as of the end of a fiscal year; and

"(F) the term 'accounts payable' includes collections and reinsurance fees due (but not paid) to the Department of Education, as of the end of a fiscal year.".

(b) CONFORMING AMENDMENTS.—

(1) The second sentence of section 428(c)(1)(A) of such Act (20 U.S.C. 1078(c)(1)(A)) is amended by striking out "shall be deemed" and inserting "shall, subject to section 422(e), be deemed".

(2) Section 428(c)(9)(A) of such Act is amended by striking out "an amount equal to" and inserting "an amount, subject to section 422(e), equal to".

(3) The second sentence of section 428(f)(1)(B) of such Act is amended by striking out "shall be deemed" and inserting "shall, subject to section 422(e), be deemed".

SEC. 3002. REPEAL

(a) IN GENERAL.—Subsection (e) of Section 422 of the Higher Education Act of 1965 (20 U.S.C. 1072) is repealed on September 30, 1989.

(b) CONFORMING AMENDMENTS.—

(1) Effective September 30, 1989, the second sentence of section 428(c)(1)(A) of such Act (20 U.S.C. 1078(c)(1)(A)) is amended by striking out "shall, subject to section 422(e), be deemed" and inserting "shall be deemed".

(2) Effective September 30, 1989, section 428(c)(9)(A) of such Act is amended by striking out "an amount, subject to section 422(e), equal to" and inserting "an amount equal to".

(3) Effective September 30, 1989, the second sentence of section 428(f)(1)(B) of such Act is amended by striking out "shall, subject to section 422(e), be deemed" and inserting "shall be deemed".

34 C.F.R. § 682.410(a) (1988)

FISCAL, ADMINISTRATIVE AND ENFORCEMENT REQUIREMENTS

(a) *Fiscal requirements.* A guarantee agency shall establish, at a minimum, the following fiscal procedures:

(1) The guarantee agency shall establish and maintain a reserve fund to which the guarantee agency shall credit—

(i) Federal advances obtained under, and matching funds required by, section 422(a) of the Act;

(ii) Funds appropriated by a State for the agency's loan guarantee program;

(iii) Federal advances obtained under § 682.403;

(iv) Funds received by the guarantee agency as loan insurance premiums;

(v) Administrative cost allowances received by the guarantee agency under § 682.407;

(vi) Funds received by the guarantee agency for the agency's loan guarantee program from gift, grant, or other sources;

(vii) Funds collected on defaulted loans;

(viii) Death, disability, bankruptcy, and reinsurance payments received from the Secretary; and

(ix) Funds earned from investments under paragraph (a)(5) of this section.

(2) Except as provided in paragraphs (a)(3) and (a)(4) of this section, a guarantee agency may use the assets of the reserve fund established under paragraph (a)(1) of this section only to—

(i) Guarantee loans under the guarantee agency's loan guarantee program;

(ii) Pay default claims;

(iii) Pay death, disability, and bankruptcy claims;

(iv) Refund overpayments of insurance premiums;

(v) Pay to the Secretary the Secretary's equitable share of borrower payments; and

(vi) Repay advances made by the Secretary.

(3) Except as provided in paragraph (a)(4) of this section, a guarantee agency may also use loan insurance premiums, administrative cost allowances, interest or investment earnings, and funds described in paragraph (a)(1)(vi) of this section for payments necessary for the proper administration of the guarantee agency's loan guarantee program.

(4)(i)The guarantee agency may use the amount of Federal advances identified in paragraph (a)(1)(iii) of this section, and interest or other earnings on those advances, only to pay default claims.

(ii) The guarantee agency shall account separately for the funds described in paragraph (a)(4)(i) of this section.

(5) The guarantee agency may invest the assets of the reserve fund described in paragraph (a)(1) of this section only in low-risk securities, such as obligations issued or guaranteed by the United States or a State, and shall exercise the level of care in that investment required of a fiduciary charged with the duty of investing the money of others.

(6) If the guarantee agency uses loan insurance premiums or funds earned from investments under paragraph (a)(5) of this section to buy an asset and—

(i) If the agency subsequently sells that asset, the agency shall promptly deposit into the reserve fund described in paragraph (a)(1) of this section a percentage of the sale proceeds equal to the percentage of the original purchase price of the asset paid with the insurance premiums and investment earnings; or

(ii) If the agency subsequently converts the asset to a use unrelated to its GSLP or PLUS loan guarantee program, the agency shall promptly deposit into the reserve fund described in paragraph (a)(1) of this section a percentage of the fair market value of the asset equal to the percentage of the original purchase price paid with the insurance premiums or investment earnings.